Chapter 3

Rules of Origin in Indian PTAs: Design, Restrictiveness, Enforcement and Circumvention

3.1: Introduction

RoO, as discussed in the introductory chapter, are a set of criteria that define nationality of traded products. They are an essential part of all trade rules. When used to define ‘originating’ products from PTA members, they are referred to as preferential RoO, which are used to determine whether preferential tariffs or MFN tariffs will be charged on intra-PTA traded products. RoO used for determining origin of traded products on MFN basis i.e. traded in non-preferential terms, are known as non-preferential RoO. Our study focuses on RoO within PTAs i.e. preferential RoO. Apart from determining origin of the products, RoO in PTAs play a very important role, especially in the FTAs – they check trade deflection. In all PTAs, RoO try to ensure that tariff preferences are granted only to imports from member countries and not to non-member imports. In FTAs they are also the tools to prevent trade deflection – unlike deep integration trade arrangements like CUs, FTA members retain their own tariff barriers against non-member imports. Thus there remains a chance that non-member imports may get routed through the lowest-tariff member country to rest of the FTA members to take advantage of the tariff differential. RoO make sure that a product exported by a member is not such a simple trans-shipment but that sufficient working or processing has been done to it in the exporting member before it claims to be ‘originating’ from there. Thus they are important in the effective functioning of a PTA. However, they also are increasingly being used by countries as commercial policy tools per se, instead of being just supportive instruments to the commercial policies of the PTAs. In the first chapter it was discussed that RoO can be designed in a way to restrict trade. A strict design of RoO is likely to deter traders in
using a PTA and thereby can insulate particular industries from trade liberalising effects of the PTA.

This chapter tries to evaluate the design of RoO under India’s various PTAs. In the next section the restrictiveness of design of any RoO regime is discussed. Section 3.3 evaluates the design of RoO regimes in India’s PTAs with respect to their trade restricting capacities. Effect of such restrictiveness on India’s partners is commented upon in Section 3.4. Section 3.5 looks into the implementation challenges, and discusses circumvention of RoO that was witnessed in India-Sri Lanka trade. Section 3.6 summarises the chapter.

3.2: RoO design and their restrictiveness on trade

The criteria to resolve the issue of origin are relatively simple for primary goods: they have to be ‘wholly obtained’ in their exporting country. However, for manufacturing goods that are not ‘wholly obtained’ in a single country, the specific rule for determining ‘origin’ is ‘substantial transformation’, meaning origin accrues to the country in which the product underwent ‘substantial transformation’. Each PTA has its own set of rules to determine this ‘substantial transformation’ criterion. These take mainly three forms: change in tariff classification (CTC) in the processing of the final commodity from its intermediate inputs; minimum value to be added in the exporting country (regional value content or RVC, also known as value addition or VA and domestic value addition or DVA rule); and specific technical requirements (TECH), which set out specific production activities that may (positive test) or may not (negative test) confer originating status. Depending on the design of these criteria, a RoO regime can be termed as restrictive or not as is clear from the discussion below.

With CTC test there is the issue of the level of the classification at which change is required. The higher the level, the more restrictive effect it will have. Most agreements specify that the change should take place at the heading level of the HS (4-digit level). However, in NAFTA RoO for some products require a change at the chapter level (HS 2-digit level), which is considered to be more restrictive. Also, given that the HS has 1,241 categories at the 4-digit level as against over 5,000 at the
6-digit level it readily implies that requirement of a CTC at the 4-digit level will not be possible to attain for many products (Hoekman 1993).

VA has the issue of valuation of materials. Depending on the method of valuation (ex-factory, fob or cif), the values of non-originating materials differ. Ex-factory, fob, cif are all sales contract terms used in international trade. They divide transaction costs and responsibilities between seller and buyer. Ex-factory in a sales contract implies the seller (exporter) makes the goods available at his/her premises (factory). The buyer (importer) is responsible for all costs and risks thereafter. Fob (free on board) implies the seller of the cargo has responsibility till he puts the goods on board of the ship. Risks are transferred to buyer from there on. Cif (cost, insurance and freight) is fob plus cost of ocean freight and marine insurance, which implies that the seller is also responsible for the transport of goods till the port of destination. Thus an ex-factory cost basis is considered to be the narrowest valuation basis, and origin rules incorporating this provision are treated as the most restrictive on this account. Less restrictive valuation bases, in order of restrictiveness, include fob and cif. This can be shown from the following example. RoO VA requirements can be expressed either as maximum import content or minimum domestic value content in percentage terms. Say for a PTA a minimum 50 per cent value addition is required. This can be written as

\[
\frac{\text{value of final product}^{34} - \text{imported input value}}{\text{value of final product}} \times 100 \geq 50\% 
\]

Now say that the value of imported input used in making a product is US $ 50. And say ex-factory cost is US $ 80 (this is cost at factory premises), fob (which includes transport cost from factory to port) is $ 100 and cif value of the final product is US $ 120 (as it now includes cost of ocean freight and insurance too). If the valuation base chosen for this particular PTA is ex-factory cost then domestic value added (DVA) in exporting country is \( \frac{80-50}{80} \times 100 = 37\% \); if fob was the chosen valuation base then DVA = \( \frac{100-50}{50} \times 100 = 50\% \); for cif DVA becomes \( \frac{120-50}{50} \times 100 = 58\% \). Thus with respect to restrictiveness agreements using ex-factory basis (as in some EU sector specific RoO) is deemed to be more restrictive and cif least restrictive.

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34 Value of the final good is nothing but the net cost of the export product in ex-factory, fob or cif terms.
The TECH criterion states for each product certain manufacturing or processing operations that define origin (positive test), or that do not confer origin (negative test). One example is that of EU RoO for clothing products that stipulate “manufacture from yarn”. The setting of technical requirements (TECH) often involves the participation of local industries in providing the technical inputs that is required. This lets industries influence the drafting of RoO in such a way that it becomes restrictive and protects their own interests. For example, the EU RoO for clothing products actually protects its domestic producers.

These three tests can be used singly or in combination. For example, AFTA applies only the value added criterion across all products. However, NAFTA applies all the three rules, product by product, leading to a complex set of RoO. For some agreements, instead of being product-specific, RoO is general i.e. the rule applies to all products. For example, India’s initial agreements employed the twin criteria of CTC at heading level and a specified DVA for all products. But later on India has negotiated general rules along with some product specific rules also. In India-Singapore CECA, the general twin rule applies to all products except those mentioned in an annex, of about 40 pages, which have product specific RoO: for some only a VA rule, for some only a CTC at heading or sub-heading level and for some exceptions to CTC (ECTC). Setting of product specific RoO (PSRO) is common practice in many PTAs. PSRO can be quite complicated and have high trade-restrictive effects as was shown in Brenton and Imagawa (2005, pp. 192) where the authors discussing the RoO under NAFTA give the following example – RoO for men’s or boys’ overcoats made of wool (HS 620111) is - “A change to subheading 620111 from any other chapter, except from heading 5106 through 5113, 5204 through 5212, 5307 through 5308 or 5310 through 5311, Chapter 54 or heading 5508 through 5516, 5801 through 5802 or 6001 through 6006, provided that the good is both cut and sewn or otherwise assembled in the territory of one or more of the Parties.” This RoO basically stipulates a CTC at chapter level and specifies a list of headings and chapters from which inputs cannot be used. Thus, in effect the overcoat must be manufactured from the stage of wool fibres forward, because neither imported woollen yarn (HS 5106–5110) nor imported woollen fabric (HS 5111–5113) can be used. The rule also restricts use of imported cotton thread (HS 5204) or imported thread of man-made fibres (HS 54) in sewing the coat together. Thus this indeed is a very restrictive RoO.
Presence of supplementary rules (like *cumulation*, *de-minimis*, *absorption* etc.) besides the three main methods of determining origin tries to relax the stringency of a RoO regime and thus has important policy implications. *Cumulation* (bilateral, diagonal or full) allows producers of one PTA to use non-originating materials from other PTA member(s). It thus relaxes stringency of the VA rule. *Territoriality* or *outward processing* provisions go beyond the *cumulation* provisions in allowing the use of materials from non-member countries. Origin rules that limit or disallow origin being conferred on goods produced using outsourcing and outward processing arrangements are treated as more restrictive than rules that do not. This has important implication in today’s world where many manufacturing activities are using outward processing in a number of instances. Again, if an export product cannot meet the CTC rule one way out is the *tolerance* or *de minimis* rule. This rule states that a good may still be originating if the value of the non-originating materials, which do not undergo the tariff shift, do not exceed a specified percentage of the value of the good. The *roll-up* or *absorption* principle allows intermediate products that have acquired originating status by meeting specific processing requirements are considered to be 100% originating when used as inputs in manufacturing another good. Thus the import content in these intermediate inputs is not taken into account in subsequent VA calculations of the final product. The importance of this rule can be found from the infamous Honda dispute between US and Canada under the US-Canada FTA (see Appendix 3.1, page 146). Then there are rules related to *duty drawback* schemes, which allow tariffs on imported materials used in the production of export items to be waived or refunded. In origin rules, access to drawback provisions can be restricted or denied entirely, raising the cost of exporting to member economies and encouraging firms to purchase inputs from potentially higher-cost local sources. Origin rules that disallow or derogate drawback arrangements for exporters are treated as more restrictive than rules that do not.
3.3: RoO design in Indian PTAs

3.3.1: The design

The primary criteria of RoO (CTC and RVC) differ amidst India’s PTAs. The levels of RVC and CTC differ from agreement to agreement. There are no TECH rule requirements for any sector but there are PSRO in the later agreements like SAFTA, Singapore CECA, Japan CEPA etc. These differing RoO criteria are given in Table 3.1. In some of the agreements there is provision for *cumulation* rule (bilateral), which relaxes the value to be added in the exporting country by some percentage.

There are two additional clauses related to RoO in all the PTAs. First, the final manufacturing process must be done in the territory of the exporting country (*geographic location of manufacturing* rule). Also products should be directly consigned from the exporting country to the importing country (*direct consignment* rule). *Direct consignment* means that the exported products are transported to the importing country without passing through the territory of any other third country, which, given the geographical proximity for most of the PTAs (except MERCOSUR countries and Chile), is not difficult to meet.

If all these rules are satisfied, the exporter gets RoO certificate for his/her product, the Certificate of Origin (CoO) and ships it to the importer who can then avail tariff preferences under the specific PTA. To get preferential treatment under the PTAs an importer has to produce a CoO (shipped by exporter in advance) at the time of importation. CoO is issued by various Export Inspection Agencies (EIAs) under the Export Inspection Council (EIC) in India for all the agreements. A few other organisations can issue CoO for SAPTA and APTA like the Federation of Indian Export Organisation, various Export Promotion Councils, and GoI product development boards like Spices Board, Tea Board etc.
**Table 3.1: Differing RoO in India’s PTAs**

<table>
<thead>
<tr>
<th>PTAs</th>
<th>DVA</th>
<th>CTC</th>
<th>PSRO</th>
<th>Cumulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>SAPTA</td>
<td>40%</td>
<td>-</td>
<td>-</td>
<td>50%</td>
</tr>
<tr>
<td>Sri Lanka FTA</td>
<td>35%</td>
<td>CTH</td>
<td>-</td>
<td>25%</td>
</tr>
<tr>
<td>Nepal Treaty of Trade</td>
<td>30%</td>
<td>CTH</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Afghanistan PTA</td>
<td>50%</td>
<td>CTH</td>
<td>-</td>
<td>30%</td>
</tr>
<tr>
<td>Thailand FTA</td>
<td>40%</td>
<td>CTH</td>
<td>Yes</td>
<td>*</td>
</tr>
<tr>
<td>SAFTA</td>
<td>40%</td>
<td>CTH</td>
<td>Yes</td>
<td>20%</td>
</tr>
<tr>
<td>Bhutan Trade Agreement</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Singapore CECA</td>
<td>40%</td>
<td>CTH</td>
<td>Yes</td>
<td>*</td>
</tr>
<tr>
<td>APTA</td>
<td>45%</td>
<td>-</td>
<td>-</td>
<td>60%</td>
</tr>
<tr>
<td>Chile PTA</td>
<td>40%</td>
<td>CTH</td>
<td>-</td>
<td>*</td>
</tr>
<tr>
<td>MERCOSUR PTA</td>
<td>60%</td>
<td>-</td>
<td>-</td>
<td>*</td>
</tr>
<tr>
<td>ASEAN CECA</td>
<td>35%</td>
<td>CTSH</td>
<td>Yes</td>
<td>*</td>
</tr>
<tr>
<td>Korea CEPA</td>
<td>35%</td>
<td>CTSH</td>
<td>Yes</td>
<td>*</td>
</tr>
<tr>
<td>Malaysia CECA</td>
<td>35%</td>
<td>CTSH</td>
<td>Yes</td>
<td>*</td>
</tr>
<tr>
<td>Japan CEPA</td>
<td>35%</td>
<td>CTSH</td>
<td>Yes</td>
<td>*</td>
</tr>
</tbody>
</table>

*The PTAs, thus marked, have provisions for cumulation but do not specify any reduced percentage of RVC. Thus the partner can use Indian ‘originating’ materials in manufacture of an article (and vice versa) but without any reduced percentage criteria norms.*

Note: Under the cumulation rule, total value added within the SAPTA region should not be less than 50%; total value added between India and Sri Lanka should not be less than 35%; total value added between India and Afghanistan should not be less than 40%; total value added within the SAFTA region should not be less than 50%; and total value added within the APTA region should not be less than 60%.

*Source*: Author’s compilation from information available at Department of Commerce website.
The *modus operandi* for getting tariff preferences under a PTA is described through a schematic diagram in Figure 3.1. It shows that to get tariff preferences an exporter in country A, which has signed a PTA with country B, will first need to apply to the designated certifying agency in A. The certifying agency will verify the claim of the exporter that his/her product fulfils RoO conditions laid down in the PTA and thus it is originating in the country. The agency checks the documents the exporter submits to it and then carries out physical inspection of the export products of the first
consignment to be shipped to the importing country. If satisfied from both documents and physical verification, the certifying agency then issues CoO to the exporter. The exporter then needs to send this document to the importer who can show it to the Customs in country B and get tariff preferences on his/her import.

Table 3.2: Number of pages devoted to RoO in PTAs

<table>
<thead>
<tr>
<th>PTAs</th>
<th>No. of pages for RoO</th>
</tr>
</thead>
<tbody>
<tr>
<td>SAPTA</td>
<td>4</td>
</tr>
<tr>
<td>India-Sri Lanka FTA</td>
<td>8</td>
</tr>
<tr>
<td>India-Nepal Treaty of Trade</td>
<td>5</td>
</tr>
<tr>
<td>India-Afghanistan PTA</td>
<td>8</td>
</tr>
<tr>
<td>India-Thailand FTA (EHS)</td>
<td>25</td>
</tr>
<tr>
<td>India-Singapore CECA</td>
<td>54</td>
</tr>
<tr>
<td>India-Bhutan Trade Agreement</td>
<td>-</td>
</tr>
<tr>
<td>SAFTA</td>
<td>23</td>
</tr>
<tr>
<td>Asia Pacific PTA</td>
<td>10</td>
</tr>
<tr>
<td>India-Chile PTA</td>
<td>20</td>
</tr>
<tr>
<td>India-MERCOSUR PTA</td>
<td>21</td>
</tr>
<tr>
<td>India-ASEAN CECA</td>
<td>29*</td>
</tr>
<tr>
<td>India- Korea CEPA</td>
<td>52</td>
</tr>
<tr>
<td>India-Malaysia CECA</td>
<td>25</td>
</tr>
<tr>
<td>India-Japan CEPA</td>
<td>56</td>
</tr>
</tbody>
</table>

* India-ASEAN CECA PSRO is still being negotiated. Number of pages on RoO will increase further when it is incorporated in the text of the agreement.

Source: Author’s compilation from agreement texts available with Department of Commerce website.

The RoO in the initial Indian PTAs are found to be simple enough compared to the later agreements as is evident from Table 3.2. The text of the first bilateral FTA between India and Sri Lanka, the India-Sri Lanka FTA (ISFTA) covers 18 pages and has an annex on RoO of only 8 pages. The initial PTAs were simple documents with few pages explaining RoO. This is mainly because the initial PTAs did not have any PSRO. They applied the twin criteria “CTC + RVC” for determining origin. In the later agreements
the policy makers negotiated product specific rules e.g. the PTAs like Singapore CECA, Korea CEPA, and Japan CEPA, each have RoO of more than 50 pages due to inclusion of lengthy PSRO. However, SAFTA, Thailand FTA and Malaysia CECA, even though they have PSRO, have fewer pages devoted to RoO, compared to Singapore, Korea and Japan agreements. The reason Thailand FTA has less number of pages is the fact that the PSRO are only on 82 items under the Early Harvest Scheme (EHS). Malaysia CECA has fewer pages on RoO as there are less number of PSRO – only 42 items at the HS 6-digit level has PSRO as compared to about 250 products each in Singapore CECA and Korea CEPA and about 170 products under the Japan CEPA (all of them including product specific rules at both 4-digit and 6-digit HS level).

Interesting thing to note is that for the Bhutan FTA there are no RoO – only a clause is inserted into the text of the agreement (Article IV) which states: “In view of the free movement of goods flowing between the two countries and of the possibility of the flow from one to the other of goods of third country origin, the Governments of the two countries shall have annual consultations.”

In the next sub-section the restrictiveness of RoO design in the Indian PTAs is analysed. Before going into the analysis it should be made clear what is exactly meant by restrictiveness of RoO. There are two ways to think about restrictiveness of RoO design – how much a rule permits, and how much it affects producers and trade. Even though somewhat similar they have differing effects dependent on specific market conditions and factor endowments. This was shown by Harris (2007, pp. 49) with an example of preferential trade in coffee. To quote:

“The rule in a given agreement could require that all coffee products be elaborated from coffee beans grown in a member country in order to qualify for the preferential tariff. Alternatively the agreement could specify that roasting and blending coffee beans from any part of the world would confer origin. In the case of a PTA between the U.S. and Canada, the former rule would (be) so restrictive as to completely eliminate the possibility of free trade in coffee because neither country has a climate conducive to the cultivation of coffee. The latter rule on the other hand would prevent pure trade deflection but would allow for free trade in coffee that had been processed (i.e. roasted and blended) in one of the countries. If the PTA were between the U.S. and
Colombia, on the other hand, the rule requiring originating beans would be less restrictive because Colombia is a major producer of coffee beans.”

The latter definition of restrictiveness, as to how much producers and trade get affected by a particular rule, is difficult to measure as it differs by products, markets and industries. Therefore, for analysing restrictiveness of RoO the first definition of restrictiveness is employed here. Thus the focus of the analysis is on how much a particular rule is capable of restricting trade.

**3.3.2: Evaluating restrictiveness of RoO design in Indian PTAs**

The nature of RoO is not readily quantifiable and they are thus difficult to compare across products and across PTA’s, unlike tariffs (Harris 2007). Thus for evaluating RoO of a particular agreement a restrictiveness index measure is usually resorted to. A restrictiveness index measure quantifies restrictiveness capability of different RoO provisions. This facilitates comparisons of RoO regimes across different PTAs. Index methodologies have been applied to analyse origin rules mainly in NAFTA and EU PTAs. Estevadeordal (2000) did the pioneering work in the restrictive index analysis of RoO. Using the basic idea of codifying the different variants of RoO, Estevadeordal constructed an ordinal index of restrictiveness of PSRO under NAFTA. For example, CTC at 2-digit chapter level is more difficult to be achieved, so it is given a higher restrictiveness score than CTC at 4-digit heading level, which in turn is given a higher restrictiveness score than CTC at 6-digit subheading level35. Estevadeordal and Suominen (2006) used this index to compare restrictiveness of PSRO of various PTAs across the world. Cadot et al. (2005) modified this index first. Harris (2007) further modified Estevadeordal’s index and calculated the restrictiveness of PSRO of five PTAs in the Western Hemisphere. Indices developed in these studies have focused on PSRO. A comprehensive restrictiveness index measure, focussing on all RoO provisions, has been developed by the Australian Government’s Productivity Commission (2004) while trying to assess economic problems with operation and design of RoO under the Australia–New Zealand Closer Economic Relations Trade Agreement (ANZCERTA). Since this is the most

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35 However, Inama (2009) state that such an assumption of hierarchy in restrictiveness is arbitrary as in many commodities such is not the case e.g. in case of chemical products a change at the sub-heading level too is extremely restrictive.
comprehensive RoO restrictiveness measure available in literature, it has been used here to assess the restrictiveness of RoO under India’s PTAs. There are criticisms of the use of restrictiveness indices as Inama (2009) states that such indices are calculated in abstract and are not matched with ground reality of industrial capabilities in a country. There are also criticisms of using arbitrary weights in calculating the Restrictiveness indices. Despite the criticisms, restrictiveness indices are simple tools to understand whether a particular regime’s design can be trade-restrictive or not. In this way they are effective in understanding more about the ex-ante effect of the rules, which is otherwise difficult to gauge.

Table 3.3: Restriction categories for preferential RoO

<table>
<thead>
<tr>
<th>Number</th>
<th>Restriction category</th>
<th>Weight</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Primary criteria</strong></td>
<td></td>
<td><strong>0.60</strong></td>
</tr>
<tr>
<td>1</td>
<td>Change in tariff classification</td>
<td>0.20</td>
</tr>
<tr>
<td>2</td>
<td>Regional value content or percentage criterion</td>
<td>0.20</td>
</tr>
<tr>
<td>3</td>
<td>Specified manufacturing process test and/or sector-specific rules</td>
<td>0.20</td>
</tr>
<tr>
<td><strong>Supplementary criteria</strong></td>
<td></td>
<td><strong>0.25</strong></td>
</tr>
<tr>
<td>4</td>
<td>Type of cumulation</td>
<td>0.05</td>
</tr>
<tr>
<td>5</td>
<td>Provisions that go beyond cumulation</td>
<td>0.05</td>
</tr>
<tr>
<td>6</td>
<td>Duty drawback</td>
<td>0.05</td>
</tr>
<tr>
<td>7</td>
<td>Territoriality or outward processing</td>
<td>0.05</td>
</tr>
<tr>
<td>8</td>
<td>Geographic location of manufacturing process</td>
<td>0.05</td>
</tr>
<tr>
<td><strong>Other effects of RoO</strong></td>
<td></td>
<td><strong>0.15</strong></td>
</tr>
<tr>
<td>9</td>
<td>Degree of certainty</td>
<td>0.05</td>
</tr>
<tr>
<td>10</td>
<td>Compliance and administration costs</td>
<td>0.05</td>
</tr>
<tr>
<td>11</td>
<td>Rigidity</td>
<td>0.05</td>
</tr>
<tr>
<td><strong>Total weight</strong></td>
<td></td>
<td><strong>1.00</strong></td>
</tr>
</tbody>
</table>

*Source: Productivity Commission (2004).*

The basic structure of the Productivity Commission’s Restrictiveness Index is reported in Table 3.3. The index methodology groups the different RoO criteria under three broad headings and assigns weights accordingly. The *primary criteria*, CTC,
RVC and TECH, get the highest weight of 0.60, as they cover the main methods of origin determination. The supplementary criteria, which look at other features of RoO (like cumulation, de minimis etc) and influence origin determination is given a lesser weight of 0.25. Certain other design issues (like rigidity etc) are grouped together in other effects of RoO, which is assigned a weight of 0.15. For variants under these three broad headings, highest restrictiveness scores are assigned to more complex origin rules and the scores are progressively lower for less complex rules.

Under the primary criteria come CTC, RVC and PSRO. Each gets a weight of 0.20. Now each PTA uses a different variant of each of the above criteria, e.g., CTC can be used at 2-digit (Chapter), 4-digit (Heading), 6-digit (Sub-heading) or 8-digit (Item) level. It is more difficult for imported inputs to undergo a manufacturing process that will result in a final good classified in a different Chapter than the imported inputs used. CTC at Heading or Sub-heading levels are progressively easier to achieve. Thus the RoO regime of a PTA, which requires CTC at 2-digit level, is considered most restrictive and thus given a restrictiveness score of 1.00. For CTC at 4-digit level the score assigned is 0.50, 0.20 for CTC at 6-digit level and it is 0.00 for 8-digit level as it is the easiest to achieve. Similarly for the RVC percentage criterion, higher scores are given for higher requirements of domestic value addition. Requirement of more than 65 per cent of value addition gets highest score of 1.00; RVC of 56–65 per cent gets lesser score of 0.80; 46–55 per cent has score of 0.6, and so on. Less than 25 per cent RVC is given the lowest score of 0.00. RVC is divided into six parts, of which the percentage criterion is explained here. The other parts are given in Appendix 3.2 (page 149). PSRO is divided into two parts: use of specified manufacturing process tests and sector-specific rules. They are each given a weight of 0.1.

Five supplementary criteria, which relax the stringency of the primary criteria, are considered in the Productivity Commission methodology: cumulation, provisions that go beyond cumulation, duty drawback, outward processing and geographic location of manufacturing process — each getting an equal weight of 0.05. Cumulation allows producers to use a certain percentage of materials from partner or other countries (relevant for the RVC rule). There are some other provisions in PTAs which go beyond cumulation in allowing non-originating materials (like tracing test, de-minimis and absorption rules). Some PTAs explicitly allow for duty-drawback to its exporters.
in case imported materials are used in the manufacture of their exports when they export to the partner country under the PTA. On the other hand, some other PTAs explicitly disallow drawback provisions when exporters use the PTA route, making them use more of local inputs. In Indian PTAs there is no specific mention of duty-drawback. Inclusion of the outward processing rule in a RoO regime allows contracting-out and commission work to other countries. None of the Indian PTAs allow outward processing. Geographic location of last manufacturing process is sometimes explicitly specified to be the exporting member (as in case of all Indian PTAs), sometimes any member of the PTA and sometimes no restriction is put.

Three other effects of RoO are laid out in the methodology: degree of certainty (if only one rule (say RVC or CTC) is followed in a PTA then it has greater certainty than combination of two or more rules of “CTC+RVC”), compliance and administration costs (in case members are part of more than one PTA, it is given a higher weight as “spaghetti-bowl” effect of complicated RoO will make trading more restrictive) and rigidity (no waiver provisions to CTC or RVC rules for any sector is considered more rigid and gets higher restrictiveness score than those PTAs that accommodate waivers to incorporate for technological or organisational changes). Thus the Productivity Commission methodology specifies different RoO criteria, gives a weight to each criterion and a score to variants of the criterion used in a particular PTA. It then arrives at a figure (weight * score) which indicates restrictiveness score of RoO regarding that criterion. Doing this for all the criteria, they arrive at a composite RoO Restrictiveness Index value for the RoO regime chosen for a particular PTA. This score can be compared with index scores of other PTAs. The index value lies between zero and unity. A higher index value (closer to unity) indicates a more restrictive trading environment on account of RoO. It should be borne in mind that this restrictiveness is based on the design of RoO in a PTA and thus gives an ex-ante sense of restrictiveness faced by firms in conforming to the rules. They cannot reflect the ex-post effects of implementation of a RoO regime on the firms.

3.3.3: Comparative analysis of restrictiveness of the RoO

The restrictiveness scores for RoO under India’s various PTAs are calculated by analysing the texts of such agreements and using the Productivity Commission
methodology. In the Productivity Commission study, Singapore-Australia FTA (also termed as SAFTA) RoO has the lowest restrictiveness score and NAFTA, not surprisingly, has the highest. Their scores are used to compare the restrictiveness of RoO scores of the Indian PTAs.

The aggregate restrictiveness score for ISFTA RoO is 0.441, of APTA is 0.361 and that of CEPA with Korea is 0.387 (see Appendix 3.3, page 157 for details of the calculation). In themselves, these figures do not reveal much. But when they are compared amidst themselves and with the RoO regimes of other world PTAs, it gives an idea as to how restrictive the rules actually are. By comparing Indian PTA RoO Restrictiveness Index scores with the least restrictive RoO (Singapore-Australia FTA) and most restrictive RoO (NAFTA), it is found that RoO variants used in Indian PTAs are of medium to high restrictiveness. This is evident from Figure 3.2.

Figure 3.2: Restrictiveness index of RoO design: Comparison of Indian PTA restrictiveness scores with Singapore-Australia FTA and NAFTA

![Chart](chart.png)

Note: The Indian PTAs are arranged chronologically – by the dates the PTAs came into force.

Source: Based on author’s calculation. Restrictiveness scores for Singapore-Australia FTA and NAFTA are taken from Productivity Commission (2004).

The restrictiveness scores portray a non-monotonic relationship as newer PTAs came into force. The RoO regimes of initial PTAs, starting with SAPTA, were medium
restrictive; later ones like the ones with Thailand and Singapore had more restrictiveness; but again recent PTAs with MECOSUR and Korea have reduced restrictiveness index scores.

India’s RoO under the various PTAs are very simple compared to their counterparts in other PTAs. Still they score higher in the restrictiveness analysis because of lack of supplementary rules in their design. Figure 3.3 brings this out. Under the primary criteria, RoO restrictiveness scores in Indian PTAs are much less than NAFTA. But for the supplementary criteria they are much higher than even NAFTA. In NAFTA RoO, there are many supplementary rules to the main methods of origin determination, which most Indian PTAs do not have (see Appendix 3.3, page 157). There are tolerance (de-minimis) rules in NAFTA, which except recent PTAs with Korea, Malaysia and Japan no other Indian PTAs have. There are provisions for outward processing (territoriality) in NAFTA which is absent in any Indian PTA. Also, like most other PTAs in the world, NAFTA is not rigid on the issue of the geographic location of the last manufacturing process. For Indian PTAs the final manufacturing process has to be carried out in the exporting country only. Thus on these counts Indian PTAs have become restrictive in their RoO design.

Figure 3.3: Restrictiveness scores by category: Comparison of Indian PTAs with Singapore-Australia FTA and NAFTA

Note: The calculations are presented in Appendix 3.3 (page 157).
Source: Based on author’s calculation. Restrictiveness scores for Singapore-Australia FTA and NAFTA are taken from Productivity Commission (2004).
Thailand FTA has the highest restrictiveness score in this study as it has scored highest under the formulation of regional value content criterion under the primary criteria. Most Indian PTAs indicate the import content method or give a choice between the import and domestic content methods. However, Thailand FTA allows the use of the domestic content method only. Formulation of the percentage test based on domestic content is more restrictive as it is open to manipulations and adds to compliance and administration costs (Productivity Commission 2004).

The important thing to note is that since such additional rules are absent for most Indian PTAs, the RoO regimes in such PTAs have more procedural simplicity. Criteria for originating products are very complicated issues in any trade agreement. Adding more clauses, stating exceptions to the general rules agreed upon, increases the complexity of a chosen RoO regime. In ascertaining country of origin under Indian PTAs, there is no such complexity involved. However, for India’s recent PTAs, especially the ones with SAFTA, Thailand, Singapore, ASEAN, Korea, Malaysia and Japan there are reasons for concern as the RoO text is not simple and do include a plethora of rules. So from short, simple, and non-restrictive RoO there are now long, complex and restrictive RoO. Most governments around the world realise the trade-restricting capabilities of these rules and are thus trying to simplify them: EU is trying to liberalise its various RoO under different PTAs; America too has negotiated less restrictive RoO for other FTAs after NAFTA – in the US-Chile and US-Singapore Agreements CTC at the 2 digit level (highly restrictive) is used but in lesser number of tariff items when compared to NAFTA (Productivity Commission 2004). Estevadeordal et al. (2009) share the “Good news on RoO in the Americas” and state that “...US RoO regimes have progressively evolved toward a more liberal framework from NAFTA ... latter agreements incorporate simpler, more practical, and less restrictive product-specific rules of origin than NAFTA did”. Perhaps the Indian trade policy makers also do realise the restrictive capacity of RoO and maybe thus they have incorporated supplementary rules in the later PTAs (Korea, Malaysia, and Japan) or chosen only a single method of determining origin (MERCOSUR, APTA), whereby the restrictiveness scores of the later PTAs have declined. Still the later PTAs have long lists of complex RoO clauses as is evident from the number of pages devoted to them in later agreements. Apart from the rules discussed here, there are rules on fungible goods and materials, indirect materials, on accessories, spare parts
and tools etc. Appendix 3.4 (page 162) gives the RoO text of the first bilateral FTA, the ISFTA, and then gives RoO of the latest agreement, the Japan CEPA. Reading the two one gets the idea of how complicated RoO have become over the years. In the initial PTAs RoO was just an annex to the main text of the agreement with few pages devoted in describing the few simple rules. In later agreements RoO are a big chapter within the text of the agreement and they have their own annexes covering certifying procedures, product specific rules etc. Thus it is imperative to evaluate these complicated sets of rules further, to find their ex-post restrictiveness, before negotiating RoO for future PTAs. However, as ex-post restrictiveness is difficult to quantify and calculate. So in the next chapter, findings are reported from a primary survey of exporters, with regards to how they view these rules, whether RoO in Indian PTAs have restricted their trade capabilities and how.

Effect of RoO on partner country markets, mainly Sri Lanka, is commented upon in the next section. The section thereafter tries to look RoO into implementation issues as they are more important than design issues.

3.4: Effect of restrictiveness of RoO on partners: the case of Sri Lanka

Hirsch (1998) points out that a big member of a PTA will be less constrained by RoO and the restrictive impact of their design, than the member having a lower factor endowment pool. He was the first to talk about the “asymmetric incidence of RoO” on different members within a PTA. So the effect of restrictive RoO on one of India’s PTA partners, Sri Lanka, the small island nation, is looked into. From a business perspective it can be logically understood that Sri Lanka, being the smaller economy, will have to bear the brunt of RoO restrictiveness and that such restrictiveness will be of lesser consequence to Indian businesses. Sri Lanka, apart from having a lower factor-endowment pool, it being an island-nation is highly dependent on other countries for most of its raw materials, intermediate inputs and capital goods. In fact Sri Lanka’s ‘import to GDP ratio’ was as high as 38 per cent in 1999, the year before ISFTA formation and it has very high import dependence in most of its important
export sectors. For example, the textile and garments sector, which accounts for half of its export earnings, had 90 per cent of its intermediate inputs imported in 1988. By the end of the 90s this came down to 60 per cent but that still is very high. As a corollary to such high import dependence the manufacturing sector has very low value addition in Sri Lanka (Weerakoon and Wijayasiri 1999). Studies have been done on utilisation of the ISFTA preferences. In Mukherji and Kelegama’s study (2007) it is stated that only 46 per cent of garment exports from Sri Lanka qualify for preferential treatment in India, the rest cannot due to inability to fulfil RoO criteria; the corresponding figure for non-garment exports was 74 per cent. Garment exports, Sri Lanka’s important export item, have suffered more because of an additional rule: there is a Tariff Rate Quota (TRQ) of 8 million pieces annually, of which 6 million should use Indian raw materials to qualify for preferential treatment. This requirement has been modified recently (Customs Notification No. 52/2008) whereby 3 million pieces of the garments under the TRQ can enter India duty-free without any requirement of sourcing of fabrics from India.

However, another study finds utilisation rates of ISFTA by Sri Lankan exporters to be quite high – as high as 99 per cent in 2003 which has come down to a still impressive figure of 75 per cent in 2008 (de Mel et al. 2011). The authors caution that such high figures are due to huge amount of preferential trade in just two items, copper and edible oils. In fact, the drop in utilisation in later years reflects trade corrective measures taken by both the governments on copper and edible oils exports from Sri Lanka. So the high utilisation rates may not reflect utilisation by other exporters. Many exporters in their survey (18 per cent) actually felt that ISFTA RoO are restrictive. There are other reports on difficulty of Sri Lankan businesses in fulfilling RoO criteria. Tea, a traditional export item of Sri Lanka, faces difficulties with RoO as CTC is not practically possible. If imported tea leaves (H.S. heading 0902) are used, the final blended-tea (the same H.S. heading - 0902) product cannot fulfill the required change in tariff heading needed under ISFTA RoO, even if it satisfies the DVA criterion. Tea exports from Sri Lanka also have a TRQ of 15 million kgs annually and initially had port restrictions – tea exports from Sri Lanka could be sent

36 TRQ: The application of a reduced tariff rate for a specified quantity of imported goods. Imports above this specified quantity face a higher tariff rate.

37 Customs notifications are available at www.cbec.gov.in.
to India only through the ports of Cochin and Calcutta. Port restrictions were removed by India in 2007 enabling Sri Lankan exporters to better utilise the TRQ (Customs Notification No. 75/2007). However, as RoO cannot be met, the quota remains largely unutilised by Sri Lankan businesses (Mukherji and Kelegama 2007). In another instance, Lanka Business Online\textsuperscript{38} (2006) reports difficulty of Sri Lankan gems and jewellery exporters to achieve 35 per cent value addition, even though CTC is satisfied, as imported gold inputs make up the main value of a finished jewellery item.

The Joint Study Group\textsuperscript{39} (2003) discussed the restrictiveness of the present RoO criteria in inhibiting potential exports from Sri Lanka. There was a Sri Lankan proposal that given their import dependence in various sectors, there should be downward revision of RoO norms. However, it is important to bear in mind that 35% DVA is one of the lowest benchmark amidst RoO of all FTAs. Moreover, the US GSP scheme (in operation since 1976), to which Sri Lanka is one of the beneficiary countries, also requires 35% DVA as does Sri Lanka’s FTA with Pakistan (implemented in 2005). So instead of a downward revision of RoO perhaps it will be better to use the two criteria of CTC and DVA more judiciously. It will perhaps make more sense to use CTC for items where CTC transformation is logical and use an alternate DVA criterion only where that transformation is impossible (say for tea). Supplementary rules may also be used to relax the stringency of the rules. For example, as CTC at the heading level is difficult to achieve a de minimis rule of 10 per cent can be employed, which implies if imported tea leaves are maximum 10 per cent of total value of final product, even when CTC is not achieved the final blended tea get ‘originating’ status in Sri Lanka through the de minimis rule.

\textsuperscript{38} Lanka Business Online, 1\textsuperscript{st} July 2006.

\textsuperscript{39} A Joint Study Group was appointed by both the governments in 2003 to investigate the possibility of achieving greater economic integration by establishing CEPA (Comprehensive Economic Partnership Agreement), which goes beyond trade liberalization in goods and covers services trade and investment too. The report was released in the same year containing a series of recommendations.
3.5: Challenges in Enforcement of RoO in ISFTA:
Circumvention of RoO

RoO add complexity not only for traders but also for customs officials and trade policy authorities. Violations of RoO are rampant. RoO, governing non-preferential trade, gained importance since the 1980s because of circumvention of these rules and ensuing anti-dumping litigations between countries. The need was felt for harmonising the different rules for all countries and thereby the harmonization work programme (HWP) started under the WTO which is still going on. However, preferential RoO are not under the HWP. Countries are free to choose different RoO under their PTAs. From Table 3.1 it is evident that there are many different RoO in India’s different PTAs. The conflicts that arise from these differing rules and the way to enforce them have important implications for trade facilitation. Proper enforcement of RoO needs adequate attention so that on one hand they do not hinder trade and on the other their misuse is checked. There are some PTA specific examples in the literature of cases of RoO violation. McNamara and Vermulst (1994) give many instances of mis-declaration of origin in the context of EC trade. There also have been instances of rent-seeking activities by origin-certifying agencies, as in Uganda, for the issuance of CoO. Pursuing the veracity of CoO is a lengthy process and routine verifications exceeded staff resources of the Uganda Revenue Authority. Resulting revenue loss from fraud was significant (World Bank 2004). In the context of ISFTA there have been some reports of gross violations of RoO, mainly their circumvention, which is looked into greater detail here.

To get preferential treatment under the ISFTA any importer at the time of importation should produce a CoO (shipped by exporter in advance). CoO are issued by the EIC in India and by the Director General of Commerce in Sri Lanka. Cases of RoO violation cropped up in just a couple of years after ISFTA came into force. First amidst them was the RoO violation case related to copper imports from Sri Lanka under ISFTA, followed by edible-oil imports. The copper case is discussed first.

Within a couple of years of ISFTA implementation there was a tremendous increase in copper items exports from Sri Lanka to India. Calculations done from data available at UNCOMTRADE (availed from WITS website) reveal that before ISFTA
Sri Lanka exported about 20 per cent of total copper exports to India. Since 2002-03 this figure had a sudden jump to 98 per cent and stayed there about till 2006-07. This extraordinary trade performance is brought out clearly from a graph. From Figure 3.4 it is found that Sri Lanka’s export of copper to India is what drives its total copper exports to the world. Also, it clearly shows the tremendous increase in recent years before a sharp fall from 2005-06. Juxtaposing this with imports of copper into Sri Lanka it is seen that there also has been a massive jump in the imports of copper from the year it has started massively exporting to India i.e. 2002-03. The two graphs exhibit similar trends. From the disaggregate data it was found that Sri Lanka started importing copper scrap & waste (H.S. heading 7404) in huge quantities after ISFTA formation from United Arab Emirates (UAE) (see Figures 3.5 and 3.6). Using imported copper scrap & waste Sri Lanka started exporting mainly refined copper & copper alloys, unwrought (H.S. heading 7403), copper wire (H.S. heading 7408) and copper bars, rods & profiles (H.S. heading 7407) to India.

Figure 3.4: Sri Lanka’s trade in copper

Note: Prior to 2000 data for Sri Lanka not available for all years.
Source: Author, based on data available with UNCOMTRADE database.
Sri Lanka does not have copper mines and prior to ISFTA it did not have any revealed comparative advantage (RCA) in copper products it was exporting so intensively to India after the Agreement (Jha 2005). The Indian copper industry, as stated in a report in The Economic Times (2005)\(^40\), alleged flouting of RoO norms. They alleged that only third country copper scrap was melted and cast into ingots and exported to India as ‘Sri Lankan’ products. Industry officials claimed that maximum value addition attainable in this process to be 7 per cent. They said that by fixing a floor price below the legitimate price of imported copper scrap i.e. under-invoicing of imported materials, the required RoO could be easily met. This can be explained from the DVA formula:

\[
DVA = \frac{\text{value of final product} - \text{imported input value}}{\text{value of final product}}
\]

If ‘imported input value’ (implying the price of imported inputs from third countries) in the numerator is reported to be less, then DVA increases and thus in paper 35 per cent value addition can be shown to be achieved.

Figure 3.5: Import of copper items into Sri Lanka

Source: Author, based on data available with UNCOMTRADE database.

\(^{40}\) The Economic Times, 12\(^{th}\) February, 2005.
The surge in Sri Lankan copper exports created a ‘critical circumstances’\textsuperscript{41} situation (Joint Study Group 2003) and it led to the posting of a circular\textsuperscript{42} in the Indian Customs departments website (dated August 13 2003), which stated, “...the Sri Lankan authorities have been informed that the rise in exports of copper is not due to genuine value-addition of 35 per cent, but due to circumvention of the value-addition norms by some unscrupulous traders.” The circular further stated, “...the Sri Lankan side has been requested to put an end to the export of copper strips and profiles immediately, and other items of copper within a period of six weeks from July 18, 2003.” This circular, however, went unimplemented and was withdrawn after bilateral discussions between the countries, which decided that London Metal Exchange (LME) prices would be the base for ascertaining copper import prices and would be revised on a monthly basis so that under-invoicing could be prevented.

The study by Mukherji and Kelegama (2007) documents that 30 projects in Sri Lanka run by Indian businessmen were doing this copper trade. Now, why the Indian businessmen were doing this trade? Firstly, the Indian businessmen were setting up

\textsuperscript{41} ‘Critical circumstances’, in PTA parlance, means the emergence of an exceptional situation where massive preferential imports are causing or threatening to cause serious injury to domestic producers difficult to repair and which calls for immediate action.

\textsuperscript{42} Customs Circular No. 73/2003 available at www.ieport.com viewed 12 August 2006.
shop in Sri Lanka because of better investment climate and availability of raw materials at cheaper price (copper intermediate inputs are free to import in Sri Lanka). Secondly, the customs-duty structure for copper products in India played an important role. For making finished copper items like wire, cables etc the producers need copper scraps and cathodes. Interestingly the import duty for them was the same as that on the finished items – in 2001 this duty was 35%. This affected the viability of domestic copper manufacturers as a finished copper product, domestically produced, cost 20 to 30 per cent more than an imported one. The FTA opened up the possibility to these domestic producers to go to Sri Lanka, where the inputs could be imported duty free from third countries and then the finished product could be exported to India again duty free and thus at cheaper prices. This finds support in The Economic Times (2004) article where it was reported that a ton of copper re-melted wire bars imported from Sri Lanka cost Rs. 20,000 less than what the domestic production cost in 2003. In recent years the Indian government has steadily cut import duty of copper inputs – in 2007-08 it was only 5 per cent. Also by making LME prices as compulsory reference price the exporters could no longer resort to the under-invoicing route. And since 2004, the Sri Lankan government stopped approving scrap copper melting projects. All these corrective steps resulted in a dip in copper imports after 2005-06 (as seen from Figure 3.4). There have been reports of shutting down of many Indian owned companies doing copper trade, as they were no longer competitive in doing business from Sri Lanka.

From the copper case it is clear that RoO norms were circumvented by simple accounting manipulation and it took 4 years before such malpractice could be checked. The same story was repeated with edible oil imports. During 2006 there was a hue and cry about cheap vanaspati imports into India from Sri Lanka and Nepal under the PTAs. Amidst edible oils vanaspati suddenly became a very important import item. India maintains a high customs duty on palm oil imports (in 2003 it was about 80 per cent). Palm oil is the raw material to make vanaspati. The high customs duty on it is meant to reduce imports and promote use of local varieties of oil seeds in the manufacturing of vanaspati in India. Sri Lanka (and Nepal) on the other hand has a lower duty (about 25 per cent in Sri Lanka and only 5 per cent in Nepal in 2003) and does not impose any customs duty if the finished product (edible oils) is subsequently

exported. To cash in on the difference, just like the copper case, Indian manufacturers started setting up companies in Sri Lanka (and Nepal) to make edible oils (HS code 151620) especially *vanaspati* (HS code 15162091) for export to the Indian market. This resulted in a surge of imports of *vanaspati* from Sri Lanka (and from Nepal too) during 2004-2007 as can be seen clearly from Figure 3.7. From Figure 3.8 the dominance of Sri Lanka in imports of *vanaspati* can be clearly seen.

**Figure 3.7: Top 3 exporters of Vanaspati to India**

![Graph showing the top 3 exporters of Vanaspati to India from 2003 to 2009.](image)

*Note: Before 2003 India did not import vanaspati from any country.*

*Source: Author, based on data available with INDIATRADES database.*

**Figure 3.8: Import of Vanaspati into India**

![Graph showing the import of Vanaspati into India from 1999 to 2009.](image)

*Source: Author, based on data available with INDIATRADES database.*
It was popularly believed that vanaspati was made in Sri Lanka from Malaysian palm oil imports. However, the data shows a different story. Comparing Figures 3.8 and 3.9, it can be clearly seen that India’s imports of edible oils (final product) from Sri Lanka and palm oil (raw material) imports of Sri Lanka from Singapore follows the same trend. Whereas imports of palm oil from Malaysia (see Figure 3.9) are much less in value and continue to rise in Sri Lanka even when the final product, edible oil, exports from Sri Lanka to India has fallen in recent years.

Figure 3.9: Sri Lanka’s imports of crude palm oil from Singapore and Malaysia

![Graph showing imports from Singapore and Malaysia](image)

Note: Prior to 2000 data is not available for all years for Sri Lanka.
Source: Author, based on data available with UNCOMTRADE database.

The oil imported from Sri Lanka and Nepal is much cheaper than Indian domestic varieties, due to the difference in the customs duty structure of palm oil. The Indian Vanaspati Producers Association and the Vanaspati Manufacturers Association of India protested against the surge in imports from these two countries. Like the copper case the dispute was between two groups of Indian producers – one in India and the other in Sri Lanka. The Indian producers contended that RoO did not ensure genuine value addition in the exporting countries. CTH was fulfilled – imported palm oil heading 1511 and final export product vanaspati heading 1516. Vanaspati is made by the simple process of hydrogenation (adding hydrogen to crude palm oil). The Indian manufacturers said that in Nepal and Sri Lanka the palm oil was 100 per cent
imported. So, required 35 per cent value addition (30 percent in case of Nepal) was shown by including profit margins in the domestic value added calculations. In India, the manufacturers stated that the local value addition is done by using 12 per cent of essential oils (sesame oil) in the process of making vanaspati. Adding these essential oils is mandatory in India. The associations also contended that Nepal vanaspati is “dumped” in the Northern and Eastern states, while that from Sri Lanka is going to the Southern states affecting the domestic players in these areas (Economic Times 2006, Financial Express 2006, Business Standard 2006 and Business Line 2006).

The pressure from Indian producers led to an announcement on June 4, 2006 that vanaspati imports from Sri Lanka was to be undertaken only by the state-run National Agricultural Cooperative Marketing Federation (NAFED). However, this canalisation decision was reversed in six months, following protests in Sri Lanka, and instead a TRQ of 2.5 lakh tonnes was introduced for Sri Lanka (see Appendix 3.5, page 182). For Nepal, there already was a TRQ of 1 lakh ton. On its part, the Sri Lankan government have in recent years introduced a special levy on crude edible oil imports. Sri Lanka also has agreed not to issue any more licences to manufacture edible oils.

Copper imports under ISFTA and edible oil imports under ISFTA and India-Nepal PTA came to India with proper CoO. It is a problem for developing country authorities to verify claims of exporters requesting for preferences. Also, there were no provisions in India’s earlier PTAs, before the Singapore CECA, that provided necessary powers to importing country authorities to verify or request for verification the meeting of RoO norms by partner country exporters. For better enforcement of the rules joint verification and/or certification mechanism by both country government agencies is a possible solution. In the Joint Study Group (2003) Sri Lanka accepted this viewpoint: “...the Sri Lankan Government has indicated that it would have no objection to Indian Customs and/or trade officials being based in Colombo...”. In later PTAs an article on “Verification of Origin” is generally incorporated. “Bilateral Safeguard Measures” have also been incorporated in later agreements to tackle situations like the copper and edible oils whereby duty reduction in a PTA leads to “serious injury” or “threats to serious injury” to domestic industry (see Appendix 3.6, page 184). Also bilateral discussions at regular intervals will help check delay in

taking corrective steps. It should also be kept in mind that any circumvention of RoO should be tackled immediately to avoid distress to domestic industry. Implementation issues are important and without their proper handling domestic industries can get affected and this ultimately may lead to welfare loss.

3.6: Summary

India’s RoO regimes have evolved from simple, short texts with few rules to complex, long texts with a plethora of rules as newer PTAs have been negotiated. This chapter tried to evaluate the design of these RoO as in the literature it is well established that particular designs of RoO have trade restrictive effects. Index methodologies have been applied to assess restrictiveness of RoO regimes under European and North American PTAs. Indexes developed in such studies focussed on primary provisions of the product-specific origin rules. The Productivity Commission’s 2004 study constructed a more comprehensive index, based on both general and product-specific rules, and studied restrictiveness of RoO regimes in Australia and other country PTAs. This index has been used for expanding the restrictiveness of RoO analysis to trade agreements involving India. The analysis brought to the fore some interesting results. It was found that on a comparative scale the RoO regimes under Indian PTAs are medium to high restrictive. The increase is also non-monotonic –initial PTAs had medium restrictiveness, which increased with later agreements, but after the Thailand FTA there is again a decline in restrictiveness implying more liberal RoO design in the latest PTAs. The high restrictiveness scores of the RoO designs of some of the PTAs were found to be on account of absence of supplementary rules in such PTAs. Still, since it is procedurally simple to have fewer rules, absence of supplementary rules should not be a major issue. However, for small countries this restrictiveness may deter their ability to export through the preferential route. This was the case with the small island nation of Sri Lanka: its heavy import dependence on inputs for most of its manufacturing industries, made even the ‘medium-restrictive’ RoO of ISFTA (as found from this analysis) to be ‘high-restrictive’ for their businesses. This was pointed out in bilateral discussions between the countries and a request was put forward by Sri Lanka for a downward revision of the 35 per cent DVA norm.
However, the US GSP scheme, to which Sri Lanka is one of the beneficiary countries, also requires 35 per cent DVA as does Sri Lanka’s FTA with Pakistan. Thus instead of reducing the already low DVA requirement supplementary rules or product specific rules may be used to relax the stringency of the rules. This may make things complicated than the general (and simple) twin criteria of RoO followed in ISFTA now, but this may help the traders as when they find a general rule closes their option of using the PTA, an alternate rule (a product specific rule – say for a particular product there is a “CTC or DVA” rule) or a special rule (a supplementary rule – say if CTC not possible to achieve a de minimis rule may be applied and if DVA is not possible an absorption rule may be followed) will make it easier for them to use preferences for their products.

Effort should also be given to the enforcement of these rules. It was witnessed that by simple techniques (under-invoicing of imported inputs or including profit margins in DVA calculations) RoO could be circumvented in case of copper exports from Sri Lanka and edible-oil exports from Sri Lanka and Nepal. This exposed the vulnerability of the rules to trade malpractices. The copper case also revealed one of India’s major trade policy problems – the inverted customs duty structure, whereby raw materials and intermediates have higher tariffs than finished products. In most countries raw materials and intermediates attract lesser customs duties than a finished product. It was because of this that Indian companies went to Sri Lanka manipulated RoO and did business in copper from there. Thus firstly domestic reforms in the customs duty structure is needed to stop industries from misusing the PTAs. Then effective implementation of the rules is required through joint verification and/or certification mechanism. Timely bilateral discussions are also of paramount importance. Later agreements, like India-Korea CEPA, have included clauses on verification, safeguards and penalties to check and stop violation of RoO.